

No. 11397.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of

ABBOT KINNEY COMPANY,

Alleged Bankrupt.

E. A. GERETY, WILLIAM HARRAH, CHARLES BROWN and
HAROLD POOL,

Appellants,

vs.

ABBOT KINNEY COMPANY,

Appellee.

APPELLANTS' OPENING BRIEF.

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APPELLANTS' OPENING BRIEF.

Opinion Below.

The memorandum opinion of the court below is reported in 66 Federal Supplement 841 [R. 178].

Statement of Jurisdiction.

The United States District Court for the Southern District of California claimed and asserted jurisdiction over the parties and the subject matter by reason of an amended involuntary petition in bankruptcy filed by three alleged creditors against Abbot Kinney Company [R. 5]. See Title 11, Chapter 2, Section 11, United States Code, Annotated.

This court has jurisdiction by reason of Section 24, subdivision (a) of the Bankruptcy Act, Title 11, Chapter 4, Section 47, United States Code, Annotated, page 360.

Statement of Case and Questions Presented.

The questions involved and the manner in which they were raised are:

First Question: Whether three bond holders who did not waive their security, may file an involuntary petition in bankruptcy, particularly where because of the running of the Statute of Limitations the holders of the bonds lost all right to maintain any proceeding for a deficiency judgment and where their rights were only to foreclose on the real property which was security for the bond issue and then only to proceed in concert by action of the trustee for and on behalf of all bond holders?

The question is raised by the amended involuntary petition [R. 5], the answer of the alleged bankrupt [R. 141] and the objection to jurisdiction [R. 42 and 43].

Second Question: On the filing of a defective involuntary petition, may the alleged bankrupt institute proceedings to determine the validity of a conditional sales contract and to establish a trust in respect thereto over the objection to jurisdiction by the holder of said contract? This question is raised by the petition for order to show cause [R. 17], objections by appellants [R. 42 and 43] and answer of appellants [R. 31, 35, 39].

Third Question: Where parties to a proceeding stipulate and the stipulation is approved by the court, may the court over the objection depart from the approved stipulation when the objection is raised by answers of appellants herein? [R. 31, 35, 39; Stipulation, R. 167.]

Fourth Question: Where the involuntary petition in bankruptcy was dismissed, was it error not to dismiss a summary proceeding instituted by the alleged bankrupt against the appellants herein over their objection to the jurisdiction of the District Court? This point is raised by motion for dismissal [R. 145], memorandum order of the District Court [R. 178] and the order appealed from [R. 185].

Fifth Question: Did the court err in denying a creditor the right to intervene and in not granting the motion to dismiss? This point is raised by petition [R. 131], motion [R. 139] and Points and Authorities [R. 174].

Sixth Question: Did the Referee err in making findings of fact that were made and did the District Court err in approving the same on review, where said facts were contrary to the evidence and not supported by the evidence? This point was raised by petition for review [R. 45], Referee's findings [R. 61], transcript [R. 196] and the order appealed from [R. 185].

Seventh Question: Was it error for the District Court upon its own motion and contrary to the evidence, to modify the Referee's order that the appellants were entitled to be reimbursed or credited with \$15,000.00, the purchase price of a conditional sales contract and to find and order that the appellants be reimbursed only in the sum of \$10,000.00, where such finding and judgment is based on the fact that one year previous to the purchase of the conditional sales contract by the appellants, the said contract was offered to the appellee for \$10,000.00? [R. 185].

Statutes Involved.

The applicable statutes are set forth in the Appendix, *infra*, pages 1 to 3.

Statement of Facts.

The Abbot Kinney Company, a corporation, on the 1st day of April, 1931, executed a trust indenture securing a bond issue of \$350,000.00, first mortgage bonds, under which bond indenture the California Trust Company was made trustee for the owners and holders of the outstanding bonds and was vested with the right to act for all bond holders [R. 585, 588].

By reason of the Statute of Limitations, Section 336a, subdivisions 1 and 2, of the Code of Civil Procedure of the State of California, there was no right at the time of the filing of the involuntary petition for the bond holders to proceed against the Abbot Kinney Company for any deficiency judgment and the bond holders only had the right to act through the trustee to foreclose on the property secured by the trust deed [R. 143, 379].

On the 2nd day of June, 1931, the said company had installed a sprinkler system on its pier at Venice, California, under a conditional sales contract, whereby F. R. Cruickshank & Company held the legal title to said contract until installments therein provided were paid to them. The Statute of Limitations was extended from time to time on the said contract, and on June 13, 1944, appellants Brown and Gerety purchased the same from the Cruickshank Company for the sum of \$15,000.00. At the time of the purchase there was due on the contract the sum of \$137,181.30 [R. 65, 110].

For a number of years prior to June, 1944, a controversy existed between the bond holders and their representatives and two groups of common stock holders of the Abbot Kinney Company in respect to the control of the company and its operations. One stockholders' group was headed by Al Newton, Phillip Davis, one of the attorneys of record, and his brother and father. The bond holders' group was represented by John Harrah, Frank Williams and Lewis Halper; and the other stockholder's group was represented by Carlton Kinney and Helen Kinney Ward.

During a portion of this period, certain amusement concessions were leased and operated by appellant Charles Brown, and the Abbot Kinney interests at the pier were managed by Ed Gerety, and the board of directors functioned through an executive committee which was composed of Carlton Kinney, Al Newton and John Harrah [R. 325, 421].

During 1943 there were negotiations between the Davis group with the Cruickshank Company to acquire, at a discount, the conditional sales contract covering the sprinkler system which was an important improvement in connection with the pier operations. This group was negotiating to purchase the contract for themselves and had received an offer from the Cruickshank Company to sell the contract for \$10,000.00. No offer was made in 1943 or at any other time directly to the Abbot Kinney Company for it to purchase the contract [Darling's testimony, R. 392]. However, on the day the option of the Davis group expired, one of their members offered the contract to the corporation for \$10,000.00 [R. 393], but the executive committee and bond holders group were opposed to the

use of any money to acquire the said contract [R. 321, 389] at this particular time because the corporation didn't have \$10,000.00 available to buy the contract and furthermore, it needed the available funds to pay delinquent taxes [R. 493]. After January 1943 to about April 1944, the contract which previously had been offered to various groups for prices ranging from \$25,000.00 to \$50,000.00, was sought by Lewis Halper, the Davis group, a concessionaire named Phillips, but no sale of it was made [R. 399]. In May 1943, there was an abortive attempt to change the executive committee of the company by the Davis group and Charles Brown and Ed Gerety were notified that they were removed from their connection with the company [R. 242, 327, 338]. Thereafter, Gerety and Brown, commencing about June 6, 1944, negotiated with the Cruickshank Company [R. 242] and succeeded in purchasing the conditional sales contract on or about June 13, 1944. Title was taken in the name of Brown [R. 249]. Demand was made upon the corporation for payment of \$7,500.00 to keep the contract in force for ninety days which sum was paid by the executive committee. Thereafter and at the expiration of the ninety days, demand was made for payment of the \$30,000.00 annual installment due under said contract, and in the demand it was proposed to credit the company with \$50,000.00 if this installment was paid. About the time of that demand, the Davis group called a stockholders' meeting for the election of a new board of directors, and on the date of said meeting said sum of

\$30,000.00 was paid upon the contract, and this payment was after the filing of the involuntary petition in bankruptcy [R. 346, 348, 499].

Said involuntary petition was filed in the United States District Court by three bond holders [see R. 2 to 4, incl.] alleging that the payment of \$7,500.00 was payment on an antecedent debt and constituted a preference and an act of bankruptcy [R. 4]. That petition was later amended without material change [R. 5 to 7, incl.]. An answer was filed to said involuntary petition [R. 8 and 9, incl.].

A petition for order to show cause was filed by the alleged bankrupt and an order to show cause was issued thereon and served upon the appellants herein [R. 17]. Thereupon, the parties entered into a stipulation [R. 25, 167], by which the \$30,000.00 paid by the Abbot Kinney Company to Brown and Gerety would be deposited with the clerk of the court *to await the determination of whether or not the company would be adjudged a bankrupt*. The agreement further provided for expediting the hearing on the bankruptcy petition. *The court approved the stipulation* on January 9, 1945 [R. 171] and dismissed the order to show cause. Reference was made to a referee to determine the issues raised by the amended involuntary petition and amended answer thereto, and the same was set for hearing on the 17th day of July, 1945 [R. 207]. *Prior to that hearing and in violation of said stipulation*, a petition [R. 17] and order to show cause [R. 29] was filed to have the court *determine title to the*

sprinkler contract and to the \$30,000.00 on deposit with the court. This petition and order to show cause were returnable on July 16, 1945. Respondents under that order, the appellants herein, objected to the jurisdiction of the court [R. 43, 199], and on the ground that it was contrary to the approved stipulation. That objection was overruled and answers were filed and respondents were forced to a hearing on that order. Following the hearing the Referee entered findings of fact and conclusions of law and an order determining the title to said sprinkler contract to be in the corporation, and that the corporation owned the \$30,000.00 less the amount paid by Brown and Gerety, to-wit, \$15,000.00 [R. 61-79], and less the \$7,500.00 paid in June 1944. The appellants herein petitioned the District Court to review the order of the Referee [R. 45] and on review the District Judge required the Referee to hear and determine the involuntary petition and the issues raised therefrom [R. 144] and the Referee found that the same should be dismissed [R. 178]. Thereafter the District Judge entered the order appealed from herein [R. 185]. Appellant appealed from the order of the District Court under Section 24, subdivision (a) of the Bankruptcy Act, Title 11, Sec. 47, United States Code, Annotated, p. 360 [R. 193].

Statement of Points to Be Urged.

1. The District Court had no jurisdiction to entertain the Summary Proceedings resulting in the order appealed from.
2. No persons qualified to file an involuntary proceeding signed or joined in the involuntary petition.
3. The involuntary petition does not state an act of bankruptcy.
4. The alleged bankrupt cannot institute proceedings to recover a preference and to quiet title and to establish a trust against an adverse claimant prior to adjudication.
5. Where the parties to a stipulated procedure to be followed and the Referee approved that stipulation, it is error to permit a repudiation of the stipulation.
6. Where involuntary petition was dismissed, it was error not to dismiss summary proceedings instituted by the alleged bankrupt.
7. The court erred in denying a creditor the right to intervene and in not granting the motion to dismiss.
8. The Referee erred in making findings of fact and conclusions of law which are not supported by or sustained by the evidence and the District Court erred in approving the same.
9. The District Court, on its own motion and contrary to the evidence, modified the Referee's order, by reducing the reimbursement figure from \$15,000 to \$10,000. This was error.

ARGUMENT.

I.

The District Court Had No Jurisdiction to Entertain the Summary Proceedings Resulting in the Order Appealed From.

Appellant contends that the United States District Court had no jurisdiction in respect to the proceedings appealed from for the following reasons:

(a) That *no person or creditor qualified* to file an involuntary proceeding, as required by the Bankruptcy Act, as amended, *was a party to said amended involuntary petition.*

(b) That the amended involuntary petition does not state an act of bankruptcy.

(c) That the alleged bankrupt is not vested by the statute with the authority to institute a proceeding *to recover a preference and to quiet title and establish a trust* against adverse claimants *prior to an adjudication.*

(d) That the controversy was a subject matter of a plenary action that would have had to be instituted in the state courts.

NO PERSONS QUALIFIED TO FILE AN INVOLUNTARY PROCEEDING HAVE SIGNED OR JOINED IN THE INVOLUNTARY PETITION.

Under the 1938 amendment to the Chandler Act, Section 59 (U. S. C. A., Title 11, Chap. 6, Sec. 95), it is provided:

“Who may file and dismiss petitions. a. Any qualified person may file a petition to be adjudged a voluntary bankrupt.

b. Three or more creditors who have *provable claims fixed as to liability* and *liquidated as to amount* against any person which amount in the aggregate in excess of the value of securities held by them, if any, to \$500 or over; or if all of the creditors of such person are less than twelve in number, then one of such creditors whose claim equals such amount may file a petition to have him adjudged a bankrupt."

Section 1.11, U. S. C., Title 11, Chap. 1, Sec. 1.11, defines a creditor as:

" 'Creditor' shall include anyone who owns a debt, demand, or claim provable in bankruptcy"

Section 1.14 defines "debt" as:

" 'Debt' shall include any debt, demand or claim provable in bankruptcy."

Claims provable in bankruptcy are defined in Section 57, Subs. a to n, of the Bankruptcy Act (U. S. C., Title 11, Chap. 6, Sec. 93). Subdivision d provides:

"Claims which have been duly proved shall be allowed upon receipt by or upon presentation to the court, unless objection to their allowance shall be made by parties in interest or unless their consideration be continued for cause by the court upon its own motion. Provided, however, that an unliquidated or contingent claim shall not be allowed unless liquidated or the amount thereof estimated in the manner and within the time directed by the court; and such claim shall not be allowed if the court shall determine that it is not capable of liquidation or of reasonable estimation or that such liquidation or estimation would unduly delay the administration of the estate or any proceeding under this Act."

Subdivision e provides:

“Claims of secured creditors and those who have priority may be temporarily allowed to enable such creditors to participate in the proceedings at creditors’ meetings held prior to the determination of the value of their securities or priorities, but shall be thus temporarily allowed for such sums only as to the courts seem to be owing over and above the value of their securities or priorities.”

This question has been passed upon by the 7th Circuit Court in the case of *Central Illinois v. Flori Pipe Co.*, 133 F. (2d) 657, 660, as follows:

“Since the amendment of 1938, it is doubtful if a single creditor whose claim is secured, even though the debt greatly exceeds the security, may qualify as one who can file an involuntary petition in bankruptcy without giving up his security. The Act, 11 U. S. C. A., sec. 95, requires that petitioner’s claim be ‘fixed as to liability and liquidated as to amount.’ Inasmuch as a secured creditor has a petitioning claim only for the difference between the amount of the debt and the value of the security, his claim is not liquidated. He therefore must fail to measure up to the qualifications of a petitioning creditor in an involuntary petition unless he waive his security.”

Remington states the rule, Sec. 254, 1944 Supp., p. 104:

“Nevertheless, the statement in the text, to the effect that contingent claims are not sufficient for petitioning creditors’ claims, still is correct law. This is because Sec. 59b, as amended, by the Act of 1938, 11 U. S. C. A., Sec. 95b, requires not only that the

claims of the petitioning creditor be provable, but further requires that such claims be 'fixed as to liability and liquidated as to amount.' See the discussion in Sec. 211.10, of this treatise, *ante*."

against 1944 Supp., p. 94, Sec. 211.10,

"The Amendatory Act of June 22, 1938, amended Sec. 59b, 11 U. S. C. A., Sec. 95b, of the Bankruptcy Act, so as to require that the claims of the petitioning creditors be 'fixed as to liability and liquidated as to amount.'

"This new requirement obviates the necessity of passing upon and determining the amount of such claims at the inception of the proceeding."

The petitioning creditors as the owners of a few of the bonds out of the entire issue were not creditors under Section 1.11 since they did not "own a debt . . . provable in bankruptcy. The obligation of the Abbot Kinney Company is set forth in the Trust Indenture, as follows [R. 585]:

"All rights of action on or because of the bonds issued hereunder or the interest coupons thereto appertaining and all rights of action under this Indenture are hereby expressly declared to be vested exclusively in the Trustee, except only as hereinafter provided; (447) and such rights may be enforced by the Trustee without the possession of any of the bonds issued hereunder or the interest coupons thereto pertaining. Any suit or proceeding instituted for the Trustee shall be brought in its name as Trustee, and any recovery or judgment shall be for the pro rata benefit of the bonds issued hereunder and the interest coupons thereto appertaining." [R. 379, 585.]

The right to take action against the Abbot Kinney Company was vested in the trustee under the Trust Indenture. *The three petitioning creditors owned no debt they could prove or use to file an involuntary proceeding in bankruptcy.* The amended involuntary petition shows *on its face* the nature of their position [R. 6, Par. 5]. The petitioning creditors' amended petition recites [R. 6, last line]:

"That your petitioners *do not waive the security* for said bonds." (Italics ours.)

It is necessary in order to invoke the jurisdiction of the bankruptcy court, that the facts required by statute be alleged in the petition. An order of adjudication is void if these facts are lacking. The rule is stated in Remington on Bankruptcy, Vol. 1, 1945 Supp., Sec. 518, p. 201:

"An involuntary petition is jurisdictionally defective if it fails to disclose the commission of an Act of bankruptcy. Such defect is sufficient ground for vacating adjudication. Where the defect appears affirmatively from the pleadings, the decree of adjudication is a nullity. Any creditor having a provable claim who is not estopped or guilty of laches, may attack the adjudication on the ground of lack of jurisdiction. It is the duty of the bankruptcy court *sua sponte* to dismiss the petition at any state of the proceedings where it is clear that the petition is jurisdictionally defective. The bankruptcy court has no terms but sits continuously and the rule which prohibits the vacating of judgments in a term subsequent to that in which they were entered is not applicable. The defect cannot be cured by amendment because the amendment could only become effective as of the date of application therefor."

Also:

In re Crafts Riordan Shoe, 26 A. B. R. 449, 185 Fed. 931;

In re Farthing, 29 A. B. R. 732, 202 Fed. 557.

The defects of the petition were raised and urged throughout the proceeding [R. 202, 42, 43, 145].

A direct motion was made on this ground and on the authorities submitted here [See R. 145 to 148].

THE INVOLUNTARY PETITION DOES NOT STATE AN ACT OF BANKRUPTCY.

It is alleged in Paragraph 6 [R. 7] of the amended petition that the alleged bankrupt paid out of its assets to Charles Brown, *et al.*, "The sum of \$7,500.00 on an antecedent debt due them by Abbot Kinney Company, which payment was made for the purpose and with the intent of preferring said Charles Brown, *et al.*, over the other creditors of said Abbot Kinney Company."

This allegation is insufficient to constitute an act of bankruptcy in that it *does not allege or show* that the parties receiving the payment were *unsecured creditors* or that they were in the *same class as the petitioning creditors* or that there were *any other creditors in the same class* as the parties receiving the payment.

If Charles Brown had a valid mortgage or conditional sales contract and payment could be made to him as alleged in the petition, the same would not constitute a voidable preference.

Remington, Vol. 5, Sec. 2289, p. 444, states:

"Each element of the preference must be alleged and proved."

The elements constituting a preference are (Remington, Vol. 4A, Sec. 1657, pp. 91 and 92]:

“Upon analysis it will be found that the provisions in Sec. 60, 11 U. S. C. A., Sec. 96, which define a voidable preference, may be conveniently discussed in five groups. These groups of provisions may be termed the elements of a voidable preference. They will be referred to by number and by a descriptive word or phrase.

First Element: A Transfer on an Antecedent Debt. ‘A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt made or suffered by such debtor.’ Subdivision (A), Sec. 60, 11 U. S. C. A., Sec. 96, first sentence in part.

Second Element: A Transfer Made by an Insolvent Debtor. ‘A transfer . . . made . . . by such debtor while insolvent.’ Subdivision (a), Sec. 60, 11 U. S. C. A., Sec. 96, first sentence.

Third Element: A Transfer Made within Four Months before Bankruptcy. ‘A preference is a transfer . . . made . . . within four months before the filing by or against him of the petition in bankruptcy, or of the original petition under chapter X, XI, XII, or XIII of this Act. . . . For the purposes of subdivisions a and b of this section, a transfer shall be deemed to have been made at the time when it became so far perfected that no *bona-fide* purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee, therein, and, if such transfer is not so perfected prior to the filing of the petition in bankruptcy or of

the original petition under chapter X, XI, XII, or or XIII of this Act, it shall be deemed to have been made immediately before bankruptcy.' Subdivision (a), Sec. 60, 11 U. S. C. A., Sec. 96, first sentence in part.

Fourth Element: A Transfer Resulting in an Advantage to a Creditor. 'A transfer . . . the effect of which . . . will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.' Subdivision (a), Sec. 60, 11 U. S. C. A., Sec. 96, first sentence in part.

'When the word "preference" alone is used, it refers to a transfer characterized by the first four elements: (1) Transfer to a creditor on an antecedent debt (2) made while the debtor is insolvent, (3) having the effect of giving that creditor a greater percentage in bankruptcy than other creditors of the same class, and (4) the making of the transfer within four months of bankruptcy.'

Fifth Element: Reasonable Cause for Creditor to Believe the Debtor Is Insolvent. 'Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent.' Subdivision (b), Sec. 60, 11 U. S. C. A., Sec. 96, first sentence.

'When the term "voidable preference" is used in this chapter, it means a transaction which has all five elements or characteristics. If any element is missing, a transaction cannot result in a voidable preference.' "

Remington, Vol. 4A, Sec. 1701, p. 209, discussing the fourth element, states the rule:

“Who Are Creditors of the Same Class. It was ruled in an early case of the eighth circuit which has been universally followed that the classes referred to are the classes in which creditors are grouped by Sec. 64, 11 U. S. C. A., Sec. 104, for the purpose of priority in distribution.

In re Star Spring Bed Co., 257 F. 176, 43 A. B. R. 328 (1919; C. C. A. N. J.), (affirmed in 265 F. 133, 45 A. B. R. 650), Davis, District Judge: ‘The referee further states that

“A point not argued, but appearing to me to be decisive of this case, is that one essential element of a voidable preferential transfer is entirely lacking that is, the effect of the transfer must be to enable the creditor to obtain a greater percentage of his debt than other creditors of the same class. . . . Here, however, is a creditor holding security who surrenders it and receives other security. What creditors ‘of the same class’ are there over whom he has acquired a preference? There is no proof that there were any.” ” ”

It is *essential that an act of bankruptcy be alleged* or there is no jurisdiction. The rule is stated in Remington, Vol. 1, Sec. 107, p. 158, as follows:

“But involuntary bankruptcy must be based on the commission of an act of bankruptcy, and what constitutes such act is prescribed by statute.

Not even every person nor corporation nor partnership included in the various classes heretofore considered as being subject to involuntary bankruptcy, may be forced into bankruptcy. Other con-

ditions must also, at the same time, exist. Such person or corporation or partnership must have committed what is termed an act of bankruptcy.

The Bankruptcy Act was not intended to cover all cases of insolvency, but only such cases as are within its provisions.

Thus, the mere fact that an individual or copartnership refuses or is unable to pay his or its debts is not an act of bankruptcy.

And the statute specifies what acts constitute acts of bankruptcy."

II.

The Alleged Bankrupt Cannot Institute Proceedings to Recover a Preference and to Quiet Title and to Establish a Trust Against an Adverse Claimant Prior to an Adjudication.

The right to institute actions against adverse claimants is founded on Section 23 of the Bankruptcy Act, and *that act limits the rights to the receiver and the trustee.*

Section 23b provides:

"Suits by the receiver and the trustee shall be brought or prosecuted only in the courts where the bankrupt might have brought or prosecuted them if proceedings under this Act had not been instituted, unless by consent of the defendant, except as provided in Sections 60, 67 and 70 of this Act."

Section 60 defines preferences and Subdivision b provides for their avoidance by the trustee. Courts have unanimously held only trustee may bring proceeding to set aside transfer, Remington, Vol. 4A, Sec. 1715, p. 267:

"Trustee's Rights in Respect of Voidable Preferences. A preferential transfer is voidable only in a

proceeding by the trustee. The trustee cannot sell his right to avoid a transfer under subdivision (b).” See *Belding-Hall Mfg. Co. v. Mercer & F. Lumber Co.*, 175 Fed. 335, 23 A. B. R. 595, and *Webster v. Barnes Bkg. Co.*, 113 F. (2d) 1003, 43 A. B. R. (N. S.) 613.

“Preferences under Sec. 60, 11 U. S. C. A., Sec. 96, given by a corporation are not voidable by its stockholders if the estate is sufficient to pay general creditors. Creditors cannot sue to set aside voidable preferences.”

Section 67 relates to voidable liens, while the Act uses the term “void.” This court has held the term means “voidable.” See *W. S. Pigg & Son v. U. S.*, 81 F. (2d) 334. Trustee is given the right to preserve transfer for benefit of the estate.

Section 67, Subdivision 4, confers upon the trustee or debtor.

Sec. 70, Subd. a, provides that the trustee shall be vested by operation of law, and then follows the vesting of rights in the trustee to property fraudulently transferred, etc.

None of these sections confers upon the alleged bankrupt the right to sue adverse claimants upon actions which prior to bankruptcy would require trial in the State Court.

Prior to the amendment of 1938 a receiver was not named in the Act as being entitled to prosecute actions, and this court in the case of *Stanton v. Busch*, 59 F. (2d) 668, 669 (9th C. C. A.), held only the trustee could

bring the proceeding and the court could not confer jurisdiction:

“The court jurisdiction was limited to appointment after first finding it absolutely necessary to conserve the estate, and the power of the receiver to hold the property was limited to the qualification of the trustee. The property came into *custodia legis* when the petition was filed, and the ancillary receiver was only the custodian to hold it until the trustee qualified. *Cameron v. United States*, 231 U. S. 710, 34 S. Ct. 244, 58 L. Ed. 448. Upon qualification of the trustee, the title vested in the trustee. *Mueller v. Nugent*, 184 U. S. 1, 14, 22 S. Ct. 269, 46 L. Ed. 405. This obtains whether the estate may be located within or without the district. *Robertson v. Howard*, 229 U. S. 254, 33 S. Ct. 854, 57 L. Ed. 1174. The jurisdiction of the bankrupt estate was and is exclusive in the court of the Northern District. *Isaacs v. Hobbs Tie & T. Co.*, 282 U. S. 734, 736, 51 S. Ct. 270, 75 L. Ed. 645.”

“A bankruptcy receiver is purely statutory, and his power is limited by the statute. He has no power, nor can a court by order confer power, to adjudicate the right of lien claimants. *Boonville Nat. Bank v. Blakey* (C. C. A.) 107 F. 891. See, also, *In re National Grain Corporation* (C. C. A.) 299 F. 597.”

Also:

In re Cox Baking Company, 77 F. (2d) 294.

Congress, in giving the receiver practically the same powers as possessed by the trustee, *did not* see fit to *include*

the alleged bankrupt, and the reason for the rule is quite clear. If there is an adjudication the trustee should institute the litigation and possesses the powers of a creditor holding an execution returned *nulla bona*, as well as the rights of the bankrupt. *The alleged bankrupt should not be permitted to prosecute litigation before the appointment of the trustee*, nor can it have determined controversies with third parties in the court and under the rules that follow upon an adjudication and the bankruptcy court taking over the administration of the estate.

As pointed out by the court in *In re Vancouver Book & Stationery Co., Inc.*, 46 Fed. Supp. 799, preference is valid as against the alleged bankrupt, and it is only *after an adjudication and the appointment of the trustee* that a transfer creating a preference is subject to attack, and if the bankruptcy proceeding is later dismissed the creditor receiving the preference is required to be restored to his original position. At page 800 the court states:

“It was long ago held that the surrender of the preference necessary to qualify a petitioning creditor could not properly be made to the debtor, *In re Currier*, Fed. Cas. No. 3492. Stated in another way, such surrender can be properly made only to or for the trustee for the creditors, Gilbert’s *Colier on Bankruptcy*, 4th Ed., page 780, Sec. 1058. In all respects concerning preferences and requiring surrender of them, the court under the bankruptcy law favors only the creditors. The creditor who has received a preference and the court have no object to effect a repayment to the debtor of the preference and are not required to do so. *In re McGuire*, Fed. Cas. No. 8813.

“In this case, therefore, the debtor has no interest in the preference surrendered to the court by the petitioning creditors and the debtor has no interest which will support a claim of lien by the debtor’s attorney. The creditors, other than the petitioning creditors who surrendered the preference, have no remedy in this court for any claim upon the surrendered preference because the jury’s verdict defeats the jurisdiction of this court to grant creditor relief.”

Where a question of *jurisdiction* is raised in connection with a bankruptcy proceeding, *all proceedings* should be stayed and the question of *jurisdiction* determined by the judge, as distinguished from the referee. (See *Woolf v. Reeves*, 65 F. (2d) 80, 81-82.)

The rule has also been stated in *In re Pacific States Savings & Loan Co.*, 27 Fed. Supp. 1009, 1012, by Judge of this court, as follows:

“When jurisdiction is challenged, the court’s duty to inquire into its right to entertain the proceeding is imperative. And he who invokes the court’s power must show that he is properly before it. See *KVOS, Inc. v. Associated Press*, 1936, 299 U. S. 269, 57 S. Ct. 197, 81 L. Ed. 183; *McNutt v. General Motors Acceptance Corp.*, 1936, 298 U. S. 178, 56 S. Ct. 780, 80 L. Ed. 1135; *Bullard v. City of Cisco*, 1933, 290 U. S. 179, 54 S. Ct. 177, 78 L. Ed. 254, 93 A. L. R. 141; *Saint Paul Mercury Indemnity Co. v. Red Cab Co.*, 1938, 303 U. S. 283, 58 S. Ct. 586, 82 L. Ed. 845; *Zicos v. Dickmann et al.*, 1938, 8 Cir., 98 F. 2d 347; *Allen v. Clark*, 1938, D. C., 22 F. Supp. 898.”

III.

Where the Parties Stipulated as to Procedure to Be Followed and the Referee Approved That Stipulation, It Is Error to Permit a Repudiation of the Stipulation.

The \$30,000.00 found to be in the possession of the Bankruptcy Court was placed there by an adverse claimant under a stipulation executed by the alleged bankrupt and the petitioning creditors through their attorneys of record, the adverse claimants' attorney of record also executed the stipulation and the Referee in Bankruptcy thereafter approved the same.

This stipulation is a part of the record here [R. 167 to 171] and it is clear from the reading of the same that the parties intended and stipulated in clear language that the \$30,000.00 was to be held *until first the question of whether the Abbot Kinney Company was a bankrupt was determined*. The petitioning creditors and the alleged bankrupt stipulated that that question would be *determined with expedition*; stipulation further provided for the dismissal of a proceeding against Charles Brown to recover the \$30,000.00. *In violation of the stipulation*, the alleged bankrupt brought on a proceeding to determine the *title* to the \$30,000.00, and in further violation of the stipulation, consented to a continuance and delayed the determination of whether the involuntary petition should be dismissed. This flagrant violation of the agreement of the parties between themselves and with the court has been sanctioned by the Referee and the District Court. If this policy is

to be pursued in the future, the sanctity of an agreement between counsel and with the court will be seriously impaired. [See R. 167, 169.]

The District Judge recognized this requirement. See his order of December 14, 1945. [R. 144.]

“This is a review of the order made and entered by Referee Benno M. Brink, dated August 23, 1945.

“The matter will be held under submission and in abeyance until there is filed with the court findings and report of the referee in bankruptcy, Benno M. Brink, as special master. When the court is in possession of these facts, the issues involved in the voluntary petition in bankruptcy and the answer thereto, the court will be in a better position to act.

“The files show clearly that the petitioning creditors and alleged bankrupt have stipulated under date of January 8, 1945 that the said issues would be prosecuted with due diligence. The court made an order wherein the issues presented by the involuntary petition and the answer were referred to Benno M. Brink, referee, for hearing and report as special master on July 24, 1945. The court is not advised the cause of this long delay. The attention of the special master is called to Rule 53 D (1) of Federal Rules of Civil Procedure: ‘It is the duty of the Master to proceed with all reasonable diligence.’

“It Is Therefore Ordered that the said special master proceed with the hearing of said controversy heretofore referred to him by order dated July 24, 1945.

“Dated December 14, 1945.

J. F. T. O’CONNOR
Judge.”

The District Judge again stated in his opinion of May 27, 1946 [R. 182] as follows:

“The court could assume or reject the jurisdiction herein exercised. *In view of the agreement of the parties*, and in view of the spirit and provisions of the Bankruptcy Act, the contested involuntary petition in bankruptcy *should have been expeditiously disposed of and every collateral matter deferred*, if possible, and relegated to the other courts after the dismissal of the involuntary petition—but we have had a most thorough and complete trial of the controversy. The records show most extensive presentation, examination and cross-examination of witnesses, production of documents, and the Referee’s findings are extensive and complete.”

Orderly procedure would require that the question of whether the Abbot Kinney Company should be adjudged a bankrupt, and its affairs administered by the Bankruptcy Court, through the Court’s representative, a trustee in bankruptcy, elected and appointed as provided by law, be *first determined* if the company was a bankrupt. The court’s time and offices should not be used to permit the litigation of a controversy that the Federal Courts have *no jurisdiction to determine*. If the company be adjudged a bankrupt, the suit should be prosecuted under the Bankruptcy Act by the parties and as provided by law, and as we have shown above, that party is a receiver or trustee in bankruptcy and not the alleged bankrupt.

The reason for the above rules of procedure are quite clear and a dangerous precedent will be established if departure be permitted. For example, the alleged bankrupt institutes a proceeding to have a constructive trust established or in connection with a contract and if unsuccessful, later if there is an adjudication, the trustee would have the duty and right to institute the same proceeding and subject the adverse claimant to a multiplicity of actions. A further example, would be where it involves a conditional sales contract that the trustee might elect to reject, as he is given the power so to do, again, the litigation would be fruitless. A further example would be by filing an improper involuntary petition by persons not entitled to file the same as was done in the case at bar; the Federal Court would be used to determine, in a summary manner, before a Referee in Bankruptcy, a controversy that the respondents are entitled under the Constitution and decisions to have determined by the State Courts in accordance with State Court procedure including among other rights, the right of a trial by Jury.

Appellants *throughout the proceeding urged these fundamental principles*, and at the commencement thereof, filed a written objection to the court proceeding. The Referee has seen fit to proceed with the hearing of the controversy, and postponing the hearing of a matter which Congress has specifically stated must be heard with expedition. (See Section 18, Subdivision d of the Bankruptcy Act.)

IV.

**Where Involuntary Petition Was Dismissed, It Was
Error Not to Dismiss Summary Proceedings In-
stituted by the Alleged Bankrupt.**

The issues raised by the amended petition and the amended answer in respect thereto were heard and the special master reported to the District Judge, recommending that the involuntary proceeding be dismissed. [R. 151.] A motion to dismiss the involuntary petition was likewise made by Harold B. Pool. [R. 145.] The District Judge approved the report of the special master and dismissed the proceeding. [See R. 178.] All matters were heard and form a part of the judge's memorandum order of May 27, 1946. [R. 178 to 184.] The dismissal of an involuntary proceeding carries with it all pending proceedings. (Remington Vol. 1, Sec. 493, p. 610; Supp. 45, p. 192.)

In re McGuire, Fed. Cas. No. 8813;

In re Vancouver Book & Stationery Co., Inc., 46
Fed. Supp. 799.

As stated in the latter case:

"The creditors, other than the petitioning creditors who surrendered the preference, have no remedy in this court for any claim upon the surrendered preference because the jury's verdict defeats the jurisdiction of this court to grant creditor relief."

We respectfully submit that when the District Court dismissed the involuntary proceedings that said dismissal

effected a dismissal of *all proceedings* including the order appealed from herein, and under the stipulation approved by the court [R. 167], the court erred in not granting appellants' motion to dismiss the entire proceeding relating to the order to show cause and the order of the Referee and leave the parties to litigate their controversy before a court of competent jurisdiction.

V.

The Court Erred in Denying a Creditor the Right to Intervene and in Not Granting the Motion to Dismiss.

The petition to intervene to oppose the amended involuntary petition was filed July 18, 1945 [R. 131] and motion was made for an order permitting Harold Pool, as a creditor, and John Harrah, a director, to intervene. [R. 139.] Points and authorities in support of motion. [R. 174.]

This motion and the points and authorities sought to raise the legal insufficiency of the involuntary petition and the relationship between the attorney for the petitioning creditors and the alleged bankrupt, and would have permitted an early determination of the jurisdictional question instead of permitting it to be postponed until the order to show cause was determined.

The referee denied the motion. [R. 199, 200, 201.]

Appellant Harold Pool moved the District Court to dismiss the involuntary petition. [R. 145.]

The points and authorities [R. 146] raise the defects of the amended involuntary petition. The District Judge took the motion under submission. All matters were disposed of by his memorandum order of May 27, 1946 [R. 178] and the written order appealed from. [R. 185.]

It is clear from the above record that the petitioning creditors and the alleged bankrupt from October 21, 1944 to May 27, 1946, tried to evade a determination of the defective petition, and that this course of conduct met with the approval of the Referee. This strategy was to force a trial in a court that had no jurisdiction and have determined a controversy that should have been determined in some other court.

The District Court's conclusion that the petition should have been dismissed before the hearing on the order to show cause is clearly the law, his conclusion that, because appellants were erroneously forced to try the matter before the Referee, was no ground to upset the judgment, is, we submit, not the law.

The petition of Appellant Pool to intervene as a party in interest and have done what the bankruptcy act requires, was not permitted and the same was a reversible error. (See Bankruptcy Act, Section 18 (U. S. C., Title 11, Chap. 4, Sec. 41, Subd. d).)

“If a party entitled to appear and plead shall appear, within the time limited, and controvert the facts alleged in the petition, the court shall determine, as soon as may be, the issues presented by the pleadings, without the intervention of a jury except in cases where a jury trial is given by this Act, and make the adjudication or dismiss the petition.”

VI.

The Referee Erred in Making the Following Findings of Fact and the District Court Erred in Approving the Same in Respect to the Following Material Facts:

1. That there was a fiduciary relationship between E. A. Gerety, John Harrah, William Harrah or Charles Brown and the Abbot Kinney Company and that the purchase by Charles Brown and E. A. Gerety of the Cruickshank contract was a violation of that fiduciary relationship.

2. That there was a conspiracy between E. A. Gerety, John Harrah, William Harrah and Charles Brown to defraud Abbot Kinney Company of the Cruickshank sprinkling contract.

3. That there was a conspiracy between E. A. Gerety, William Harrah and Charles Brown to have payments made upon said contract.

4. The court erred in modifying the findings of the Referee and in finding that Abbot Kinney Company had the opportunity of acquiring said sprinkling contract for the sum of \$10,000.00.

The Referee found and the District Court approved and adopted, among others, the following: Sometime prior to the 13th of June, 1944, at the instance and instigation of John Harrah, an unconscionable conspiracy was knowingly, wilfully, and fraudulently entered into between John Harrah, William Harrah, Charles Brown, and E. A. Gerety to defraud and cheat the Abbot Kinney Company by having the executive committee refuse to purchase the

conditional sales contract, but to have Brown, as undisclosed agent, purchase the contract for and on behalf of the conspirators [Finding XII; R. 66]; and that, in furtherance of said conspiracy, John Harrah and Carleton Kinney fraudulently and wilfully refused to accept an offer made by Cruickshank Company on or about June 6, 1944, to sell the sprinkling contract for ten thousand dollars (\$10,000.00) [Finding XIV; R. 67], and thereafter, in furtherance of the conspiracy, Brown obtained an assignment in his name. [Finding XV; R. 67.]

The Referee further found that, in furtherance of the conspiracy, Brown was paid \$30,000.00 [Finding XXII; R. 70], and that during all of the above mentioned transactions John Harrah and E. A. Gerety held fiduciary positions with the Abbot Kinney Company and were not free to act contrary or antagonistic to the best interests of the Abbot Kinney Company. [Finding XXIII; R. 71.]

The Referee further found that the Company was financially able to buy the said sales contract for \$10,000.00 on June 6, 1944; that the contract was offered to said Company on June 6, 1944, for \$10,000.00 but that it was prevented from buying the contract by John Harrah with the help, assistance and connivance of William Harrah, E. A. Gerety, and Charles Brown [Finding XXIV; R. 71]; and the Referee further found that the reason for taking the contract in the name of Charles Brown was to mislead the Abbot Kinney Company as to the interest in the contract held by John Harrah, William Harrah, and E. A. Gerety [Finding XXV; R. 71], and that all acts in connection with the acquisition of and payment on said contract were in violation of the fiduciary obligations duly owing by Gerety and John Harrah to said Company and were done

for the purpose of defrauding and cheating that Company. [Finding XXVI; R. 72.]

The Referee further found that neither Gerety, Brown, John Harrah, nor William Harrah had any right to collect any moneys on said contract. [Finding XXXI; R. 73.]

From the foregoing findings, the Referee made, among others, the following conclusions of law: That neither E. A. Gerety, Charles Brown, John Harrah, nor William Harrah had any right to collect any money on said contract or to enforce any obligations thereunder as against the Abbot Kinney Company. [Conclusion IV; R. 75.]

Further, from the testimony of petitioner's own witness, Hugh Darling, an attorney representing the Cruickshank Company, there was no offer ever made to the Abbot Kinney Company on or about June 6, 1944, to sell the sprinkler contract to that Company or to sell the contract for \$10,000.00 or any other sum. [R. 399.] Darling testified that from about 1937 to 1944 he brought up the matter of the Abbot Kinney Company making payments on the sprinkler contract. [R. 386.] The contract was never offered to the Abbot Kinney Company by Cruickshank Company. [R. 402.] At various times negotiations were had with the Davis group for the Cruickshank people to join with them and operate the Kinney Company [R. 396] and at other times, the Davis group attempted to buy the sprinkler contract. In January of 1943 the Davis group was offered the sprinkler contract for \$10,000.00. This same contract had been offered to Williams and others at prices ranging from \$25,000.00 to \$50,000.00. [R. 392.] In 1944 Phillips, a concessionaire had negotiated for the purchase of the contract. [R. 392.] Halper had offered \$12,500.00 for the

contract. Davis had had some negotiations for the purchase of the contract but no price had been agreed upon by Darling, who had authority to negotiate the sale from Cruickshank Company. [R. 392.] The only testimony relative to \$10,000.00 purchase price was the testimony of the offer in 1943 which was an offer *to the Davis group and which was not presented to the Abbot Kinney Company until the day the offer was to expire*. Evidently the Davis group finding out that the corporation had no money to purchase the contract, had Newton take the matter up with the executive committee. It is to be noted that in 1943 the company did not have \$10,000.00 with which to buy the contract. The only other mention of a \$10,000.00 figure in connection with the sprinkler contract was in June, 1944, when Gerety and Brown first offered \$10,000.00, then \$12,500.00 and then \$15,000.00 for the contract. [R. 399.] Nothing in the record supports the finding that in any month in 1944, let alone on or about June 6, 1944, the Abbot Kinney Company or anyone else had been offered the sprinkler contract for \$10,000.00. In fact, the only price for the contract in 1944 was a price of \$15,000.00, which was finally paid by appellants. [R. 399.]

As will be more fully discussed hereafter, there has been no showing that E. A. Gerety violated any fiduciary obligation duly owing to the company.

In discussing the alleged violation of any fiduciary relationship by Brown, Gerety, William and John Harrah, it might be well to determine generally what powers the officers, agents, or employees of a corporation might have in regard to corporate affairs that could in any manner touch upon the matter here involved, namely, the purchase of the Cruickshank contract.

The law generally holds that officers of a corporation, including the president, secretary, and treasurer, have no rights, merely by virtue of the office they hold, to execute contracts on behalf of a corporation. (See *Jacob v. Gratiot Central Market Co.*, 257 Mich. 262, 255 N. W. 331. See, also, Annotations, 5 A. L. R. 1485, 107 A. L. R. 996; *Laird v. Michigan Lubricator Co.*, 153 Mich. 52, 116 N. W. 534; *Chemical National Bank v. Wagner*, 93 Ky. 525, 20 S. W. 535.)

The officers of a corporation are not generally regarded as having the power, by virtue of their office merely, to purchase real or personal property on behalf of the corporation, or to make a contract for its purchase. (*Blen v. Bear River & A. Water & Mining Co.*, 20 Cal. 602.)

The officers or agents of a corporation have no inherent power to borrow money on behalf of the corporation. (*Sentney v. Central Cattle Loan Co.*, 119 Kans. 545, 240 Pac. 586.)

The officers or agents of a corporation have only such power to release, settle, or compromise claims owing to the corporation as is conferred upon them expressly or impliedly. (*Potts v. Wallace*, 146 U. S. 689, 36 L. Ed. 1135.)

As to the particular powers of the four alleged co-conspirators, we find the following:

(a) As to E. A. GERETY (hereinafter referred to as "Gerety"):

Gerety, from 1937 to December 13, 1944, was the nominal general manager of the Abbot Kinney Company. [R. 435.] He had the power to employ help but not to employ heads of departments without authorization of the board

of directors. [R. 434.] He did not have the authority to discharge workmen without the authority or approval of the executive committee [R. 434], and could make ordinary, every-day purchases of supplies. [R. 577.] He had no power to enter into leases for and on behalf of the corporation, but did have the power to negotiate for leases with prospective tenants and then submit proposed leases to the board of directors or the executive committee. [R. 577.] He had no power to enter into any contracts for and on behalf of the corporation, to compromise debts, claims or litigation, to employ legal counsel, or to hypothecate, pledge, sell, or purchase property for the corporation. [R. 576 and 577.] In fact, from the testimony produced at the trial, Gerety had only limited powers and duties with respect to the corporation, falling far short of the powers of a general manager, and he had no general or discretionary powers or duties with respect to the corporation other than as to daily routine matters.

(b) AS TO JOHN HARRAH: John Harrah was on the board of directors and a member of the executive committee. He did bear a fiduciary relationship to the Abbot Kinney Company.

(c) AS TO CHARLES BROWN (hereinafter referred to as "Brown"):

Brown was a former employee of the company who had been discharged in April, 1944. His only power and duty at the time of employment was to collect money from various tenants of the pier. [R. 219.] He was not an employee at the time of the purchase of the alleged contract, but, irrespective of whether or not he was an employee at that time, there is no evidence of any fiduciary rela-

tionship between him and to the company, except possibly to account to the company for moneys he collected from tenants during the time he was an employee.

(d) AS TO WILLIAM HARRAH: William Harrah was a bondholder of the corporation and a tenant of the corporation. He held no position in the corporation, and of course owed no duty to the same.

The evidence has produced the following facts with regard to the purchase of the sprinkler contract by Brown and Gerety;

In June, 1944, Gerety, still the manager of the corporation, discussed the purchase of the contract with Brown (who was not then an employee of the corporation) and agreed that they should purchase the same. The contract was purchased by these two individuals for \$15,000.00, for themselves and no one else. [R. 244 to 249.]

Disputed evidence as to Al Newton's desire to buy a portion of Gerety's interest in the contract was admitted, but, irrespective of Newton's motives, his efforts to buy a portion of the contract would have no bearing on the right of the corporation to set aside the purchase by Gerety and Brown if in the purchase of said contract neither Gerety nor Brown violated any fiduciary relationship to the Abbot-Kinney Company.

As soon as the contract was purchased the corporate officers knew that Brown and Gerety owned the contract, and Brown and Gerety immediately made demands for payments on it. [R. 260 to 266.] The first demand was made on June 20, 1944, and as a result thereof \$7,500.00 was paid to Brown and Gerety on the contract, with the understanding that no action would be taken by them to

sue on the contract or to enforce any of their rights for a period of ninety days. [R. 260 to 266.] Thereafter and on November 8, 1944, the sum of \$30,000.00 was paid on the contract, and Brown and Gerety agreed that the corporation would be credited with \$50,000.00 on the Cruickshank contract. [R. 274.]

There is nothing in the evidence indicating that any negotiations for the purchase by John Harrah or William Harrah, on their own behalf or on behalf of either of them, of an interest in the sprinkler contract were entered into prior to November 9, 1944. On the contrary, the evidence clearly shows that it was not until November 25, 1944, that such negotiations were entered into. [R. 279 to 286.]

On November 25, 1944, William Harrah purchased one-half of Brown's interest in the contract, thereby becoming the holder of a one-third interest in the contract. [R. 376.] John Harrah, according to the testimony—and the only testimony produced at the trial—stated that when Brown told him that he was purchasing the contract he (John Harrah) stated that in his opinion the contract could be wiped out by the bondholders, and that his advice to Brown was not to purchase the contract. [R. 323 to 325.]

The testimony shows that Halper and Williams, directors of the corporation, were opposed to the company's buying the contract. [R. 520.]

From 1937 to and including the date of the purchase of the Cruickshank contract by Brown and Gerety, no effort was made by Brown or Gerety in any manner to prevent the directors, or anyone else on behalf of the corporation, from purchasing the contract. No evidence was ever

produced that either Brown or Gerety ever suggested to any of the directors that the corporation should not purchase the contract. The evidence clearly shows that Brown and Gerety made no attempt whatsoever to negotiate for the contract until after the lapse of a period of many years in which directors and members of the executive committee of the corporation had from time to time given consideration to and negotiated for the purchase of the Cruickshank contract, and in which the corporation had failed, after those negotiations and after such consideration, to consummate the purchase of the contract. The fact is that the evidence shows that the corporation had, for at least a second time (according to Newton's testimony after many times), definitely terminated all negotiations to purchase the contract prior to the purchase by Brown and Gerety. There is nothing in the evidence to show that Gerety or Brown took any advantage of the corporation by purchasing this contract at a time when the corporation was not financially able to do so; in fact, the testimony shows that the corporation had funds in excess of \$10,000.00 which could have been used for the purchase of the contract in June, 1944. [R. 344.] There is in the record no testimony of petitioner's witness, Hugh Darling, that any of the negotiations carried on between Brown, Gerety, and Darling in any manner interfered with or prevented the corporation from acquiring the contract.

The duties of Gerety, as heretofore set forth, show that he had no power to purchase the contract for the corporation or to negotiate for the purchase of the same by the corporation, or that he had any information or knowledge concerning the contract that in any manner was not communicated to the officers of the corporation.

From the facts set forth above, it must be concluded that there was no fiduciary relationship between Gerety or Brown and the corporation with respect to the Cruickshank contract. In support of this contention are the following citations, which, it may be noted, all involve the question of the fiduciary relationship between *officers* of a corporation and the corporation. Gerety, in his position as manager and with his duties as heretofore set forth, was *not an officer* of the corporation, and the cases hereinafter cited, which all involve the relationship of an *officer* to the corporation, clearly show that under no possible circumstances could any of the acts of Gerety be considered to be a violation of any fiduciary relationship.

Section 866, article on "Corporations," 13 Am. Jur. 854:

"The relationship of a person to a corporation, whether as officer or as agent or employee, is not determined by the nature of the services performed, but by the incidents of the relationship as they actually exist. In different connections in which the question has arisen, it has been held that a mere agent of a private corporation is not an officer thereof within the meaning of statutes or regulations requiring certain acts to be done by an officer.

"One distinction between officers and agents or employees of a corporation lies in the manner of their creation. An office is created usually by the charter or bylaws of the corporation, while an agency or employment is created usually by the officers. A further distinction may thus be drawn between an officer and an employee of a private corporation in that the latter is subordinate to the officers and under their control and direction.

“In reference to particular positions in the corporation, a field manager is not an officer of the company as he has no term of office, but is merely an employee. On the other hand, the secretary of a corporation has been held to be an officer and not a mere employee. To a like effect, a director or officer of a corporation is not, by virtue of his office, its employee. Rather, a director is a part of an elected body of officers constituting the executive representatives of the corporation. However, a director’s occupancy of such office does not disqualify him from becoming its employee where the duties and incidents of his employment are separate and distinct from those pertaining to his office. Thus, a general sales manager, although he is a director and vice president of the corporation, is an employee within a statute exempting the wages of an employee from attachment.”

E. Clemens Horst Co. v. Ind. Acc. Comm., 184 Cal., holds that an officer of a corporation is one whose office is provided for by the articles or the bylaws.

See article on “Corporations”, Vol. 19, *Corpus Juris Secundum*, Sec. 800, at page 185, wherein it is said:

“A director or officer has a right to purchase the outstanding obligations of the corporation and enforce payment of the same, unless the circumstances surrounding the transaction render it inequitable for him to do so; *and where the corporation is a going concern he may purchase at a discount and recover the full value of the claim* UNLESS THERE IS A PRESENT DUTY TO ACT FOR THE CORPORATION BY PURCHASING OR EXTINGUISHING THE CLAIM, *and the rights of other creditors are not involved*. Where, however, the corporation is insolvent he is precluded from recovering more than he paid for the claim, unless by an or-

der of the court or otherwise he has shown of all power in the corporate management and his trust relationship has been wholly terminated.” (Italics added.)

See, also, *Todd v. Temple Hospital Assn. Inc.*, 96 Cal. App. 43, which case involved several claims which were assigned to the plaintiff for collection against defendant under an agreement whereby the plaintiff was to receive twenty-five per cent of the amounts collected. At the time this action was commenced, plaintiff was a *director and assistant secretary* of defendant. The claims were orally assigned to him before his official connection with defendant commenced, and formal assignments thereof were made thereafter and before the action was filed.

The trial court held that plaintiff, by reason of the fact that he was an *officer* and the assignments were for collection only, was without capacity to sue the corporation. In reversing the judgment, the District Court of Appeal said:

“In the absence of fraud or inequitable circumstances the rule that it is a violation of his trust for an officer to deal with a corporation applies only where his conduct is in the nature of an attempt to unite his personal and representative characters in the same transaction *and where his official connection is an essential part of the corporate action.* * * * Within the above rule he is not compelled by the fact alone that he is a director to forego *any* of his rights as a creditor; and in bringing an adversary action against the corporation he is not in any way taking advantage of his position as a director, the right sought to be asserted being entirely independent of his fiduciary status * * *

Monroe v. Scofield, 135 F. (2d) 725 (1943), Circuit Court of Appeals, Tenth District:

Monroe, a *director* of Gallic-Vulcan Company, a bankrupt corporation, purchased from a judgment creditor of the corporation the \$732.60 judgment for \$200.00. His claim was allowed by the District Court for \$200.00 and he appealed. In holding that Monroe was entitled to a preferred claim for \$200.00, the Circuit Court said:

“Where a corporation is a going concern, a *director may purchase a claim against the corporation at a discount and enforce it for the full amount, absent a present duty on his part to act for the corporation.*” (Italics ours.)

Possibly the leading case is *Glenwood Mfg. Co. v. Syme* (Wisc.), 85 N. W. 432. Syme was the *President and a director* of the Glenwood Manufacturing Co. In November, 1896, the company was embarrassed for want of ready money and unable to pay its debts as they matured. At that time the company was indebted to one H. L. Humphrey on two notes of \$9,000.00 each, and Syme was one of the guarantors on the notes. There were certain other obligations of the company. Humphrey had a stock interest in the corporation, and, including the notes, his interest was worth at least \$45,000.00. He sold the notes, stocks, and other obligations against the corporation to Syme, without the knowledge or consent of the plaintiff's stockholders. Syme knew that it would be greatly for the interest of the corporation to make the purchase, and he caused the same to be made in the name of W. P. Hewitt, who held the same for approximately a year and then turned over the stocks and obligations to Syme. Syme also purchased a note of plaintiff's for \$18,000.00 in

February, 1897, without the knowledge or consent of any of the stockholders. In October, 1897, Syme presented the notes that he had purchased to the plaintiff and demanded and received a note of \$29,531.18. Syme later died and during the course of the administration of his estate, payments were made on the note, and later the plaintiff brought an action for an accounting. The court, in holding that the present action would not lie, among other things said:

“The remaining question involves the right of an officer and director of a corporation to purchase outstanding liabilities of the corporation at a discount and enforce them in full. * * * The rule has been broadly stated by some of the authorities that ‘a trustee, executor, or assignee cannot buy up a debt or incumbrance to which the trust estate is liable, for less than is actually due thereon, and make a profit to himself.’ Perry, Trusts, § 428. That is the doctrine sought to be invoked in this case, as applicable to a director regarded as a trustee by the corporation. But the statement, however correct in its application to specific instances, must be taken with the limitations which belong to it. The foundation of the rule is that a fiduciary agent, owing a duty to his principal, cannot make a contract for his own benefit which is inconsistent with that duty. It is where there is a collision between trust duty and personal interest that the equitable prohibition applies. The cases usually cited to support the doctrine are where a trustee buys in the property of his principal at a sacrifice for his benefit, when, if he bought it at all, it was his duty to do it for his principal, or he makes a contract in behalf of his principal with himself, directly or indirectly, as the other party to the agreement, or where by some secret arrangement he makes a profit directly

at the expense of his principal. (Citing cases.) As before stated, the entire basis of the rule consists in the collision between trust duty and personal interest. Can it be said that any such conflict exists in the ordinary case of the purchase by a director in a going corporation of its outstanding obligations? This is the test to be applied to the facts stated in the complaint.

* * * There was no present duty resting upon Syme to extinguish the notes, so far as appears from the complaint. It is not charged that he neglected any duty he owed to the corporation in not securing funds for their discharge, or that he diverted any of its moneys properly applicable thereto to other purposes. The plaintiff's case rests upon the bald proposition that, being an officer, he could not purchase said notes at a discount. We are not prepared to accept this statement in its entirety. It is only in cases where the conflict of duty mentioned arises that the rule is received in its fullest application. Thus, in *Mor. Priv. Corp.* § 521, it is said: 'So, an agent of a corporation may purchase claims against the company at a discount, and enforce them in full, if he is not under obligation to make the purchase on behalf of the corporation.' The supreme court of Kansas approved this statement as the law in a case where the treasurer of a railroad company purchased its promissory notes at a discount, and he was allowed to enforce them at their full face value. *Railroad Co. v. Chenault*, 36 Kan. 51, 12 Pac. 303. In *Inglehart v. Hotel Co.*, 32 Hun, 377, the law is stated thus: 'So, also, a trustee or director may with his own money purchase for himself, of a third person, a valid and subsisting outstanding debt owing by the company, and secure a perfect title thereto. Such a transaction is not even the ground for entertaining the suspicion that it is in violation of any duty which he owes the corporation,

and there is no presumption of law against its fairness. * * * The other question to be considered in this connection is, will the trustee or director be permitted to enforce a collection of the debt thus acquired for its entire amount, or shall he be limited to the sum which he actually paid for the debt or obligation? I am unable to discover any good reason why he should not be permitted to enforce payment for the full amount, nor can I find any decision limiting the trustee to the sum actually paid.' "

The evidence shows that Brown and Gerety, in June, 1944, commenced negotiations for the purchase of the sprinkler contract from the Cruickshank Company. This was approximately a year and a half after the Abbot Kinney Company had refused to buy the contract for the sum of \$10,000.00. The contract was for sale; all the directors of the Abbot Kinney Company knew that the contract could be purchased; negotiations had been carried on by the Cruickshank Company with Moses Davis and he had an option to purchase the contract in January, 1943. This option expired. Williams and Halper had also carried on negotiations for the purchase of the contract for themselves. There was no evidence that Gerety or Brown directly or indirectly prevented the company from purchasing the contract. The evidence further shows that John Harrah opposed the purchase of the contract from 1938 down to June, 1944. His position was consistent in connection with the contract, and it was known at all times that he opposed the purchase of the same. The position of Carleton Kinney for over a year was also known and Kinney, as a member of the executive committee, opposed the purchase of the contract. In the event the company

desired to purchase the contract, the board of directors could have held a meeting and four of the other directors of the company could have agreed to purchase the contract at any time from 1938 to June, 1944.

In connection with any so-called conspiracy, the law seems to be well settled that a civil conspiracy can exist either to do an unlawful act or to do a lawful act by unlawful means. (See *Parkinson v. Building Trade Council*, 154 Cal. 581; *Frost v. Hanscome*, 198 Cal. 550.)

The law is well settled that the mere fact that there is a conspiracy gives no right of action unless something is done which, without the conspiracy, would itself be actionable. (*Bowman v. Wohlke*, 166 Cal. 121.)

In the instant case there are findings to the effect that the alleged co-conspirators conspired to buy the Cruickshank contract. There has been no evidence produced that there was any concert of action or any conspiracy formed up to and some time after the purchase of the contract, if at all.

A review of the evidence relative to any so-called conspiracy to purchase the sprinkler contract fails to show that either William Harrah or John Harrah was interested in, participated in, or in any manner procured, aided or assisted in, the purchase of the contract. In June, 1944, Brown and Gerety met and negotiated for the purchase of the sprinkler contract. The only evidence relative to either William or John Harrah in connection with this purchase by Brown and Gerety is the one statement that John Harrah told Brown that he thought the holder of the contract might receive nothing on the same if the bonds were foreclosed.

Assume, for the sake of argument and for this purpose alone, that there was a conspiracy between Gerety and Brown to purchase the contract, we find that there is nothing actionable in connection with such a conspiracy, for the following reasons:

It was not unlawful for either Gerety, Brown or both to purchase the contract. It appears from the discussion heretofore had of the relationship of Gerety and Brown to the corporation, and of the particular facts surrounding the Cruickshank contract, that there was no fiduciary relationship between Brown or Gerety and the corporation in connection with this contract. From the cases heretofore cited, any person could become a creditor of the corporation who was not in a fiduciary relationship with the corporation, and even officers and directors who were in fiduciary relationship with the corporation could, under the law as heretofore quoted, purchase obligations of the corporation.

Analyzing the purchase, we find that it was lawful and that no unlawful means were used in effecting the purchase. It was generally known that the contract was for sale; the corporation did not buy the contract; and after a year and a half of various negotiations between the corporation and others on the one hand and the Cruickshank Company on the other, Gerety and Brown, who bore no fiduciary relationship to the corporation, purchased the contract; Darling, the attorney for the Cruickshank Company, informed Davis and other directors that negotiations

were pending with persons other than the corporation for the purchase of the contract.

Inasmuch as the purchase of the contract of itself was not unlawful, and the means of acquiring the same were not unlawful, no action could be brought by the corporation based on a conspiracy in connection with the purchase of the contract. (See cases of *Bowman v. Wohlke*, *supra*; *Parkinson v. Building Trade Council*, *supra*, and *Frost v. Hanscome*, *supra*.)

No question can arise as to the motive of Gerety and Brown in purchasing the contract inasmuch as, if their motive was evil, the mere fact that they purchased the contract, which of itself was not unlawful, would not, under the law, be made unlawful by the fact that they were guided by an evil motive. (See *Union Labor Hosp. v. Vance Lumber Co.*, 158 Cal. 551.)

The contract was purchased by Brown and Gerety. After purchasing the same, they of course had the right to demand payment of the contract in full. They did obtain part payment on the contract. One payment made to Gerety and Brown was at a discount of \$20,000.00. There has been no evidence produced that Brown, Gerety, or either of the Harrahs, up to the time of the final payment on November 18, 1944, ever met or did any acts in concert for the purpose of enforcing payment. Neither of the Harrahs had any interest in the contract up to that period of time. Demand was made by Brown and Gerety that the corporation make payments on a legal contract, namely,

the Cruickshank contract. They certainly had the right to demand that these payments be made. At the time the payments were made the company had had a very successful year and had moneys with which to make payments on the contract. The mere fact of payment upon the contract would not of itself show any conspiracy, and this is true even though all the parties had—and there is no evidence of this—met to have the company make payments on the contract. Demand was made that the company, which was then capable of doing so, make some payments on a valid outstanding obligation. No other creditors of the company were injured by reason of this demand or payment. \$7,500.00 was paid on the contract. At a later date \$30,000.00 was paid on the contract, and the company was given credit for \$50,000.00. The right of Gerety and Brown to acquire the contract cannot be assailed, and their right to demand money on the contract cannot be assailed as having anything to do with an actionable conspiracy. The obligation being legal and being enforceable for its face amount, what is there illegal about requiring the company to pay its obligation at its face value for the full amount? If it is not illegal there is no basis for an action for conspiracy. (See cases *supra*, where it is held that an action based on a conspiracy must be predicated upon the doing of an unlawful act or the doing of a lawful act by unlawful means.)

Conclusion.

It is respectfully urged by appellants that the order appealed from be annulled and set aside.

As in this brief above shown, the lower court and the referee in bankruptcy acted :

(a) Without having the jurisdiction of the bankruptcy court ever invoked :

(1) By parties entitled to file an involuntary petition.

(2) By an original and amended involuntary petition which stated an act of bankruptcy.

(b) Where the matter tried was not the subject matter of a summary proceeding, and the debtor could not institute the same.

(c) Where the dismissal of the involuntary petition deprived the lower court of jurisdiction to proceed with further orders.

We think the record shows abuse of discretion and error where the parties stipulate to a proper procedure under the Bankruptcy Act and the court approves the stipulation and the appellants deposit the \$30,000.00 in accordance with the stipulation, and thereafter the referee permits a repudiation of the stipulation and proceeded contrary to the provisions of the Bankruptcy Act, to determine title to said \$30,000.00 in a summary proceeding. This constitutes a practice that should not be sanctioned by this court.

We think further error is apparent in that the referee denied the right of appellant Harold Pool as a creditor to intervene and declined to grant his motion to dismiss, where the alleged bankrupt and the attorney for the petitioning creditors were attempting by collusion and agreement to impose upon the jurisdiction of the District Court.

We further submit that the evidence offered does not support the findings of a conspiracy, and that if any conspiracy existed it was over a year after the company could have acquired the conditional sales contract for the sum of \$10,000.00, and that the District Judge, on his own motion, without any review having been taken by the Abbot Kinney Company, held the conditional sales contract to be acquired in trust at a price of \$15,000.00, but that the trustees were only entitled to be paid \$10,000.00 by the said corporation.

We respectfully submit that the order appealed from of May 27, 1946, be reversed and set aside.

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APPENDIX.

Section 24, Sub. a of the Bankruptcy Act:

The Circuit Courts of Appeal of the United States and the United States Court of Appeal for the District of Columbia, in vacation, in chambers, and during their respective terms, as now or as they may be hereafter held, are hereby invested with appellate jurisdiction from the several courts of bankruptcy in their respective jurisdictions in proceedings in bankruptcy, either interlocutory or final, and in controversies arising in proceedings in bankruptcy, to review, affirm, revise, or reverse, both in matters of law and in matters of fact: Provided, however, That the jurisdiction upon appeal from a judgment on a verdict rendered by a jury, shall extend to matters of law only: Provided further, That when any order, decree, or judgment involves less than \$500, an appeal therefrom may be taken only upon allowance of the appellate court.

Section 23, Subdivs. a and b of the Bankruptcy Act:

JURISDICTION OF THE UNITED STATES AND STATE COURTS. a. The United States District Courts shall have jurisdiction of all controversies at law and in equity, as distinguished from proceedings under this Act, between receivers and trustees as such and adverse claimants, concerning the property acquired or claimed by the receivers or trustees, in the same manner and to the same extent as though such proceedings had not been instituted and such controversies had been between the bankrupts and such adverse claimants.

b. Suits by the receiver and the trustee shall be brought or prosecuted only in the courts where the bankrupt might have brought or prosecuted them if proceedings under this Act had not been instituted, unless by consent of the defendant, except as provided in sections 60, 67 and 70 of this Act.

Section 60, Sub. a of the Bankruptcy Act:

PREFERRED CREDITORS. a. A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition in bankruptcy, or of the original petition under chapters X, XI, XII, or XIII of this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class. For the purposes of subdivisions a and b of this section, a transfer shall be deemed to have been made at the time when it became so far perfected that no bona fide purchaser from the debtor and no creditor could thereafter have acquired any rights in the property so transferred superior to the rights of the transferee therein, and, if such transfer is not so perfected prior to the filing of the petition in bankruptcy or of the original petition under chapters X, XI, XII, or XIII of this Act, it shall be deemed to have been made immediately before bankruptcy.

Section 335 of the Code of Civil Procedure:

INTRODUCTION. The periods prescribed for the commencement of actions other than for the recovery of real property, are as follows:

Section 336a, Subs. 1 and 2, Code of Civil Procedure:

SIX YEARS—Corporation Bonds, Notes or Debentures. Within six years. 1. An action upon any bonds, notes or debentures issued by any corporation or pursuant to permit of the Commissioner of Corporations, or upon any coupons issued with such bonds, notes or debentures, if such bonds, notes or debentures shall have been issued to or held by the public.

2. An action upon any mortgage, trust deed or other agreement pursuant to which such bonds, notes or debentures were issued. Nothing in this section shall apply to bonds or other evidences of indebtedness of a public district or corporation.

